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TAGS: EPET ENRG EINV ECON EC
SUBJECT: CANADIAN-US IVANHOE ENERGY SIGNS OIL CONTRACT WITH GOE

REF: QUITO 2650

Classified By: DCM Andrew Chritton, Reasons 1.4(b) and (d)

¶1. (U) Summary: Following 11 months of negotiations, on October 8 Ivanhoe Energy signed a contract with the GOE to develop a field of super-heavy oil using its proprietary technology. In a ceremony where he also announced replacement of the Energy Minister (septel), President Correa hailed the project as one of the "largest investments ever" in Ecuador, and emphasized that the investment showed that Ecuador welcomed foreign investment. Ivanhoe expects to invest $2-6 billion and hopes to eventually produce 100,000 barrels per day from the field. End Summary.

¶2. (U) On October 8, Ivanhoe representatives were called to a last minute ceremony at the Presidential Palace, where President Correa presided over the signing of the company's 30-year contract with the GOE and also announced Ecuador's new Energy Minister, Derlis Palacios. Ivanhoe representatives, Ecuador's Minister of Petroleum and Mines, the Minister for Strategic Sectors, the President of state oil company Petroecuador, the Canadian Ambassador, and the U.S. Deputy Chief of Mission were present. Following the signing, Correa praised the project and commented on its importance. After giving a brief summary of the contract, he welcomed foreign investment and pointed to the project as an example of how foreign companies can do business with Ecuador.

Ivanhoe and the Pungarayacu Field

¶3. (C) Although Ivanhoe Energy is a Canadian-registered company, it has significant U.S. investment and largely U.S. management. It has offices in Bakersfield, California, and Ivanhoe President and CEO for Latin America is American David Martin, a former President of Occidental Petroleum. The small firm claims a proprietary technology that can convert extra heavy oil (tar sands) into higher quality, light weight petroleum (reftel). It has been negotiating for close to a year with the GOE for a services contract to develop a large oil field that has never been exploited due to the heaviness of its crude (the Pungarayacu field, located in Napo province in the Amazon basin). Per the GOE, the field has 320 million barrels of proven reserves and is expected to produce 100,000 barrels per day (20% of Ecuador's current production).

The Contract

¶4. (C) Ivanhoe's service contract will likely be used as a model for future oil contracts as the GOE works to move all of its foreign oil contracts from production sharing (where companies bear price risk) to service contracts (where firms are paid a fixed fee for their services). The contract is for 30 years, and is really a hybrid of a production sharing contract and a service contract. In this contract, the GOE pays a fixed fee of $37 per barrel to Ivanhoe for its services. However, if the price of Ecuadorian crude falls below $37, an economic stabilization clause means Ivanhoe would share 80% of the loss. Ivanhoe would be able to recoup its 80% share of losses when oil prices rise again. The service fee will be adjusted monthly for inflation based on industry price indices. Provisions for international arbitration were a difficult issue during negotiations - the GOE only wanted to allow for local or regional arbitration and rejected the World Bank's ICSID forum (or any U.S. or British forums). However, in the end the GOE agreed to the International Chamber of Commerce in Paris as an arbitral forum.

¶5. (U) Now that the contract has been signed, Ivanhoe must obtain an environmental license, which will likely take several months, before it can initiate exploration. Ivanhoe representatives said they will not have a good understanding of what the field will produce until they conduct seismic exploration and drill several exploratory wells. Initially the firm will set up an exploration pilot project for three years, which is expected to produce 30,000 barrels per day. Following that, Ivanhoe would move to development and then

full production of the field. The company expects to invest $100 million in its first year of exploration.

Comment:

¶6. (C) Ecuador has a difficult investment climate in the petroleum sector, a point that Post made repeatedly to Ivanhoe. However, thus far, the GOE and the Canadian/U.S. company have been able to work constructively towards launching what has the potential to be a large, new foreign investment in Ecuador.

¶7. (C) Correa rescheduled the signing event so that he could participate personally. He declared "we welcome foreign investment" several times during his remarks. He emphasized that foreign companies "are willing to invest in a responsible contract in Ecuador," and noted that his government "is serious and has clear policies." For its part, Ivanhoe has been careful about cultivating its local image by developing an Ecuadorian side to its business, bringing in a local partner, hiring an Ecuadorian as manager of the project, and considering options to bring in Ecuadorian investment. It has also announced plans to open a petroleum center at one of Ecuador's universities so that it can help train potential employees.
HODGES